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Nonprofit *Alert*®

Alerting nonprofit leaders to key legal developments and responsive risk management steps

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Congress Passes Hurricane Katrina Tax Relief Act; Reintroduces CARE Act of 2005

Several significant developments have arisen on the legislative front in the wake of Hurricanes Katrina and Rita. On September 23, President Bush signed into law the "Hurricane Katrina Tax Relief Act of 2005" (H.R. 3768) ("Katrina Relief Act") which contains various provisions related to charitable giving. The purpose of these provisions is not only to increase charitable giving to organizations aiding Hurricane Katrina relief efforts, but to promote charitable giving in general for the remainder of 2005.

Among the key provisions of the Katrina Relief Act are:

• **Individuals** may deduct up to 100% of their adjusted gross income ("AGI") for cash charitable gifts made to most public charities in 2005 (up from the normal 50% AGI limitation for cash gifts). This rule applies even if the donor has income over $146,000 and is subject to the 3% phase out for itemized deductions. This heightened threshold applies to the deductibility of gifts to most public charities, but not for gifts to 509(a)(3) supporting organizations, donor advised funds, or private foundations. Nor does it apply to gifts of publicly traded stock or other in-kind donations.

> **"...we need to make sure this charitable giving applies to the whole nation, not just [in New Orleans]..." –Rep. Mark Souder (R-IN)**

• **Corporations** may deduct up to 100% of their taxable income in 2005 for gifts to public charities (up from the normal 10% limitation); provided however, that the additional donations (those above the ordinarily allowed 10%) are in cash, <u>and that they go to organizations providing Hurricane Katrina-specific relief.</u>

Other provisions of note in the Katrina Relief Act include:

• Companies that donate inventory of educational books to public schools in 2005 may claim those donations as a charitable tax deduction (such a deduction is not ordinarily allowed);

• Volunteers who use their personal vehicles to aid in Hurricane Katrina relief efforts may claim a deduction of up to $.34 per mile (up from the normal $.14);

• Those who house Hurricane Katrina victims for at least 60 continuous days may claim an additional deduction of $500 per person on their 2005 income tax return, up to a total of $2000; and

• As a part of the Work Opportunity Tax Credit ("WOTC"), employees may request that

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Hurricane Katrina Tax Relief Act....continued

their employers donate the cash value of their unused vacation, sick, and personal leave time to charities through December 31, 2006. Employers may deduct such donations as charitable contributions or business expense deductions.

While the primary aim of the Katrina Relief Act was to aid in the Hurricane Katrina relief efforts, Rep. Mark Souder (R-IN) described the broader purpose of the Act: *"We need to make sure that the broader Charitable Giving Act [HR 3908] is passed as well so that we do not dry up charities around the country [for] other people who are hurting in other areas...we need to make sure this charitable giving applies to the whole nation, not just [in New Orleans]..."*

Senators Charles Grassley (R-IA) and Max Baucus (D-MT) are working on a long-term Katrina Relief Act ("Katrina II") that may contain charitable giving reforms affecting donor-advised funds, gifts of appreciated property, supporting organizations, and executive/trustee compensation. Katrina II has not yet been introduced.

CARE Act

In early October, Senators Rick Santorum (R-PA) and Joseph Lieberman (D-CT) reintroduced the Charity Aid, Recovery and Empowerment ("CARE") Act in the Senate to stimulate charitable giving. The CARE Act (S. 1780), which has been introduced and re-introduced several times in the past several years, seeks to stimulate charitable giving and otherwise improve the tax-exempt sector through such provisions as:

- Non-itemizers could take charitable contribution tax deductions, to the extent that such contributions exceed $250 annually ($500 in the case of a joint return), but do not exceed $500 annually ($1000 in the case of a joint return);
- Individuals could make charitable contributions directly from an IRA, tax free, in certain circumstances; Repeal of the grass roots lobbying expenditure limitation; and
- Creation of several "Compassion Capital Funds" that provide for grants by the HHS, DOJ, Corporation for National and Community Service, and HUD to community-based exempt organizations providing social services.

The 2005 CARE Act also contains a few reform proposals including:

- Tax exempt organizations that are required to file Forms 990 would be required to disclose their fictitious trade names, internet addresses, and certain capital transactions on Forms 990; and
- Preparers of Forms 990 who make misrepresentations would be subject to greater penalties.

⇨ For information from the IRS relating to charitable organizations and Hurricane Katrina, see www.irs.gov/charities/article/0,,id=147267,00.html.

Court Upholds Right of Salvation Army to Discriminate on Basis of Religion

A federal district court in New York has upheld the right of The Salvation Army ("TSA") to use religious criteria in making employment decisions, but ruled that the TSA may have violated the Establishment Clause of the First Amendment by using federal funds for religious purposes.

In a suit brought by former and current TSA employees, various aspects of TSA's 2003 reorganization plan were challenged. According to the plaintiffs, that plan included a policy of "equal opportunity for employment…except where a prohibition on discrimination is inconsistent with the religious principles of the Salvation Army." The revised policy manual also described TSA's standing as a "Christian church," permitted employment decisions to be made on religious principles, required employees to acknowledge and act in accordance with TSA's religious position and beliefs, and prohibited employees from taking any action that would undermine the religious position of TSA. Several TSA employees refused to administer the forms to others, or to fill out the forms themselves. Several employees resigned, and brought suit against TSA together with several current employees. The suit alleges unlawful religious discrimination and unconstitutional entanglement of federal funds with TSA's religious mission and activities.

The court dismissed the plaintiffs' religious discrimination claims. It held that TSA did not violate the Establishment Clause or the equivalent provision of the New York Constitution because TSA was not a state

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actor. Furthermore, the Court held that TSA, as a religious organization, has the right to discriminate on the basis of religion in its employment decisions under § 702 of the federal Civil Rights Act of 1964. The court also noted that this limited exemption from nondiscrimination law is a reasonable accommodation of religious belief and practice, consistent with the First Amendment. Accordingly, the court granted TSA's Motion to Dismiss plantiffs' religious discrimination claims.

The court also dismissed plaintiffs' claim of retaliatory employment practices under federal law, citing TSA's right to make employment decisions on the basis of religion under § 702. However, it upheld plaintiff's right to proceed with a similar religious retaliation claim under New York state and local statutes, which provide narrower exceptions for religious employers. Under those statutes, the exceptions would only apply to TSA if its employment decisions were undertaken "to promote the religious principles" underlying the organization. The court stated that this is a question of fact to be determined by the trial court.

The court refused to dismiss plantiffs' claim that SA impermissibly used federal funds for religious purposes in violation of the Establishment Clause. It allowed plaintiffs to proceed with this claim on the basis that TSA allegedly diverted government funds from its social services programs to promote TSA's religious principles and tenets as part of TSA's "One Army Concept," and to hire employees on the basis of religion. The court stated that if the plaintiffs are able to establish that government funds were used by TSA for religious purposes, or if there were inadequate safeguards to prevent such use, then the plaintiffs likely will prevail on this claim. Lown v. Salvation Army, 2005 WL 2415978 (S.D.N.Y.)

> ⇨ The ability of a faith-based organization to discriminate on the basis of religion in its hiring practices, under federal and state law, depends on many facts and circumstances. These include whether the organization recites religious purposes in its organizing documents, uses religious criteria consistently in making employment decisions, requires employees to subscribe to a statement of faith or belief, and operates consistently with its religious purposes. Even if the organization has the right to use religious criteria in hiring, it may relinquish this right, in part or in whole, when it accepts government funding and agrees to comply with religious nondiscrimination provisions. For more information, see Nonprofit Alert® Memo, Hiring and Firing: Rights of Religious Employers. See last page to order.

IRS Proposes Regulations on Revocation of Tax Exemption

The IRS has released proposed criteria for determining whether to revoke the tax exempt status of an entity that approves excess benefit transactions with insiders. These proposed regulations would clarify IRS enforcement options under the "Intermediate Sanctions" law.

The "Intermediate Sanctions" law, IRC Section 4958, was adopted in 1996 to provide the IRS with an alternative to revoking an entity's exempt status when the entity approves an "excess benefit transaction"—that is, a transaction that generates a greater than fair market value benefit to an insider of the organization. Section 4958 allows the IRS to impose excise taxes on both the insider receiving the excess benefit and the organization managers who approved the transaction.

The regulations set forth several factors that the IRS should consider in determining whether an organization that approves an excess benefit transaction is organized and operated to serve private rather than public interests, justifying revocation of its tax exemption:

(A) The size and scope of the organization's regular and ongoing activities that further its exempt purposes, both before and after the excess benefit transaction or transactions occurred;
(B) The size and scope of the excess benefit transaction or transactions in relation to the size and scope of the organization's regular and ongoing activities that further its exempt purposes;
(C) Whether the organization has been involved in repeated excess benefit transactions;
(D) Whether the organization has implemented safeguards that are reasonably calculated to prevent future violations; and
(E) Whether the organization has corrected the excess benefit transaction or made good faith efforts to seek correction from the insider(s) who gained the excess benefit.

> ⇨ The IRS is seeking comments on these proposed regulations through December 8, 2005. Comments can be submitted electronically via the IRS Internet site at http://www.irs.gov/regs or the Federal eRulemaking Portal at http:// www.regulations.gov

IRS Completes Audit of The Nature Conservancy

In the March 2004 Nonprofit Alert®, and September/October 2004 Nonprofit Alert®, we reported that the IRS was conducting an audit of The Nature Conservancy ("TNC"). Recently, counsel for TNC reported at an American Bar Association meeting that the audit had been "resolved favorably" for his client. He reported that TNC retained its tax-exempt status and that the IRS has found the TNC tax returns it examined to be acceptable. Rather than imposing penalties on TNC, the IRS has reportedly recommended certain changes to TNC's operations. The audit stemmed from a series of reports in the Washington Post in 2003 alleging that TNC had participated in land-sale buy-back schemes to enable donors, including TNC insiders, to take excessive tax deductions. TNC maintains that the Post omitted pertinent facts. Since the onset of the Post's investigation, TNC has prohibited sales of land to its insiders and their immediate family members.

What is the Legal Status of "Pledges?"

A New York court has held that pledges made by former congregation members are legally enforceable, in certain circumstances.

A religious temple sought to hold a former congregant to his pledge of yearly dues. The congregant and his wife had formally resigned their memberships in the temple, and no longer felt obligated to pay the annual dues they had pledged. The temple did not dispute the validity of the resignation of the members. Nonetheless, in making the request for payment of membership dues, the temple finance chairman stated, "[a]s a Temple, we budgeted our expenses based upon your membership. While you benefited from our services when you were a member, your resignation did not relieve you of your financial obligation. We are in need of the balance of your membership dues."

> **…the temple relied to its detriment on the promise of the congregant…**

Ordinarily, absent a contractual commitment, charitable pledges are not legally enforceable because of the lack of "bargained for consideration," or negotiated exchange of value, between the parties. In this case, however, the court found that the pledge was enforceable under the doctrine of "promissory estoppel;" that is, the temple relied to its detriment on the promise of the congregant, such reliance was reasonable, and the temple would have been harmed if the member were allowed to back out of his pledge. For that reason, the court held that the member could not withdraw his promised commitment without recourse. The court noted that to decide otherwise would frustrate the reasonable expectations of donees, and violate public policy.

The court pointed out that, "one who becomes a member of a church is presumed to have voluntarily submitted to all the known tenets of congregational discipline [including the enforcement of pledges], and that…the respondent charity entered into contracts and incurred liability in reliance upon the pledge made by this [member] and others." Temple Beth Am v. Tanenbaum, 789 N.Y.S.2d 658 (Dist. Ct. 2004).

> ⇨ This case has limited precedential value, as it only applies to nonprofits in the district of New York in which it was litigated. If a nonprofit desires a donor's pledge to be enforceable, the nonprofit could enter into a written agreement with the donor that recites the terms and conditions of the pledge and gift, and describes how the charity will rely on the pledge (e.g. enter into contracts or initiate projects that depend on the donor's gift for their existence or viability). Although such an agreement could strengthen the nonprofit's position that the pledge is legally enforceable, the nonprofit should consult with local counsel about the enforceability of such a pledge under state law.

IRS Publishes Draft of Revised Form 990; Offers Waivers for E-Filing of Form 990

On October 26, the IRS released a draft of its revised Form 990 return for tax exempt entities that includes additional questions on compensation, international activities, and relationships between exempt organizations and their insiders.

The draft version requires, for instance, disclosure of compensation of former key employees and trustees. Nonprofits would also have to provide additional infor-

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mation related to whether their directors and officers have family or business relationships with each other, and whether they are paid by any organization closely connected to the nonprofit.

As part of the IRS's ongoing effort to monitor potential terrorist activities, nonprofits must be required to state on the revised Form 990 whether they exercise authority over any accounts outside the United States, and whether they distribute funds internationally.

In other Form 990 news, the IRS published temporary regulations in January 2005 that require certain exempt organizations to file their Forms 990 electronically. Recently, the IRS announced that it will grant waivers from electronic filing requirements for those organizations that can prove a need for a waiver. Such requests for waivers must be in writing, and must provide reasons for the request. The IRS stated that it will grant waivers based on financial or technological hardship involved in filing the Form 990 electronically, provided that organizations requesting waivers document in as much detail as possible the reasons for such hardships in e-filing, as compared to paper filing. The electronic filing requirements apply to entities which file 250 returns, including income tax, excise tax, employment tax, and information returns, during a calendar year. Only original returns are counted, corrected or amended returns are not counted.

The IRS stated that it will grant waivers based on financial or technological hardship...

Example: If a tax-exempt organization has 245 employees, it would be deemed to file 250 returns because each Form W-2 and quarterly Form 941 is considered a separate return; therefore, the organization files a total of 250 returns (245 W-2's, four 941's, and one Form 990.)

⇨ The Draft revisions to the Form 990 may be reviewed at http://www.irs.gov/pub/irs-dft/d990.pdf. Comments on these revisions may be submitted to the IRS through November 25, 2005 at http://www.irs.gov/formspubs/page/0,,id=10179,00.html. Also, visit the "e-file for Charities and Non-Profits" at: http://www.irs.gov/efile/article/0,,id=108211,00.html

Changes at Gammon & Grange

Gammon & Grange attorney and Nonprofit Alert editor Stephen M. Clarke has taken a position with the Internal Revenue Service's Exempt Organization Division, effective October 31, 2005. Thus, this edition is Steve's final at the NPA helm. Although we're sad to see our friend Steve leave, we are pleased that the IRS will have an attorney with Steve's knowledge of and sensitivity to the issues facing nonprofit organizations, to help it navigate today's challenging legal waters. With Steve's departure, Chip Grange will remain as editor-in-chief of the NPA, with Steve King taking a more active editorial role. We are pleased to welcome to the firm,recent law school graduate (John Marshall Law School J.D., LL.M), Brian Beckham, who will also step into an editing role with the NPA

Gammon & Grange is pleased to announce that Stephen H. King and Timothy R. Obitts have become shareholders in the firm. Steve has been a stalwart of G&G's nonprofit practice and has been the primary developer of G&G's charitable compliance practice. Tim has played a key role in the impressive growth of G&G's litigation practice in recent years and is also a valued member of G&G's communications law department. Existing G&G Shareholders Wray Fitch, Chip Grange, Nancy LeSourd, and Scott Ward are delighted to welcome Steve and Tim to this new leadership role in serving our clients.

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